**Division of Finance**

*Delivering support services of the highest quality and best value to government agencies and the public.*

I ♥ Internal Controls

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## Presentation Objectives

1. **Introduction to Internal Controls.**

2. **Introduction to the State's new Internal Control Program.**

3. **Key internal control concepts relating to:**

   a. **Cash Disbursements.**
   b. **Cash Receipts.**
   c. **Control Environment.**

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## Utah: The Best Managed State

**Utah has won various awards for being the "best managed state" in various categories, including:**
- **Money.**
- **Infrastructure.**
- **Information.**
- **Human Resources.**

UTAH

**Utah has been behind in the area of Internal Control.**

**Many states have a law, a policy, and a program.**

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## Recent Events

**U.S. Congress passed the Sarbanes-Oxley Act. (2002)**

**The National Association of State Comptrollers (NASC) developed an internal control guide and several internal control questionnaires (ICQ). (2008 through 2012)**

**Legislative Auditors issued the ABC Report. (Report 2010-12)**

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## Internal Control Objectives

**Internal Control is a process effected by management designed to achieve three basic objectives:**

- **Efficiency and effectiveness of operations.**
- **Reliable financial reporting.**
- **Compliance with federal and State laws, regulations, and policies and procedures.**

**Internal controls are what management puts in place to help ensure these objectives are reached.**

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## External Auditors

**Businesses and governments should not rely on external auditors (CPAs) as "internal controls."**

**External auditors are required to:**
- **Gain a more in-depth understanding of agency internal controls.**
- **Determine if those internal controls are properly designed, are in place, and functioning as planned.**
- **Perform risk assessments.**

**Management should do these things too.**

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## State of Utah - Internal Control Policy
FIACCT 20-00.00

**This new policy requires State agencies to do three things:**

A. **Have sound internal controls.**
B. **Have adequate segregation of duties.**
C. **Participate in the new Internal Control Program.**

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## Internal Control Program Purpose & Benefits

**The purpose** of the new Internal Control Program is to assist each State agency with its internal control responsibilities.

**The benefits** of the Program include reducing the risk of:
- Fraud and errors in financial reports.
- Loss, misuse or waste of taxpayer dollars or other assets.
- Noncompliance with State and federal laws and State policies and procedures.
- Embarrassment and repercussions that can come from related events.

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## Internal Control Program Benefits

**Other benefits include:**

- A process to assist each agency in accomplishing their internal control objectives/responsibilities.
- A process to assist the State's central management in assessing the condition of internal control systems in agencies.
- A designated contact with each agency, who has a background in internal controls.
- A designated contact with the State Division of Finance, who has a background in internal controls.

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## Phase 1: Internal Control Questionnaires (ICQ)

**What is an ICQ?**

**State agencies required to complete ICQs.**

**ICQs available on State Finance website.**

**ICQs have instructions to be followed for Comments column.**

**"No" responses require two statements in Comments column.**

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## Cash Receipts ICQ

| | | Yes | No | N/A | Comments |
|---|---|---|---|---|---|
| 1. | Are individuals who have access to cash receipts (those responsible for collection and deposit preparation) different from those individuals who record or process cash receipts in FINET (or subsystem)? | | | | |
| 2. | Are responsibilities for cash receipts functions segregated from those for cash disbursements and accounts receivable? | | | | |
| 3. | Are cash receipting functions limited to those who have a legitimate need? | | | | |

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## Internal Control Questionnaires

**ICQ List:**
- Cash Disbursements.
- Cash Receipts.
- Capital Assets.
- Payroll & Personnel.
- Receivables – FINET.
- Receivables – Non-FINET.
- Control Environment.
- Information Systems & Technology.
- Financial Reporting – Financial Statement Preparers Only.
- System Interfaces with FINET.
- Risk Assessment.

**Others ICQs exist but are not required to be submitted.**

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## Phase 2:  Internal Control Field Reviews

**Our Internal Control Auditor will periodically visit each agency to determine whether:**

- **Key ICQ questions are understood by applicable personnel.**

- **Key ICQ questions were answered accurately on the submitted ICQs.**

- **Findings and recommendations are needed.**

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## Phase 3:  Internal Control Presentation and Guide

**The Internal Control slide presentation is being offered to all State agencies - one at a time.**

**The Internal Control Guide, now available on our website, provides:**

- **A reference (1) to help managers and employees better understand the elements of their jobs relating to the internal control system and (2) for future questions and research on internal controls.**

- **Preparatory reading for this presentation.**

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## Internal Control Benefits

**What types of problems are prevented or detected by Internal Controls?**
- **Unintentional errors affecting financial statements.**
- **Intentional errors affecting financial statements (reporting fraud).**
- **Unauthorized transactions, including fraud.**
- **Non-compliance with federal and State laws, rules, policies & procedures, contracts, grants, & agreements.**
- **Wasteful spending or loss of public funds.**
- **Ineffective or inefficient policies and programs.     +**

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## Control Environment & Tone at the Top

"Control environment" refers to an agency's "corporate culture," showing how much the agency's leaders value ethical behavior and internal control.

Management's "tone at the top" sets the standard for the entire agency – not the policies and procedures – since even the best policies and procedures cannot overcome the force of a bad example.                                    +

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## Favorable Control Environment

**What are some ways management can communicate the importance of internal controls to staff at all levels?**

- **Show a positive attitude toward internal controls.**
- **Comply with management's own policies.**
- **Discuss internal controls at management meetings.**
- **Discuss internal controls at staff meetings.**
- **Reward employees for following good internal control practices.**

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## Control Environment ICQ

**The ICQ has 76 questions covering the following seven areas:**

1. **Integrity and Ethical Values**
2. **Commitment to Competence                    +**
3. **Governing Body/Audit Committee**
4. **Management Philosophy and Operating Style**

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## Control Environment ICQ

**The ICQ has 76 questions covering the following seven areas:**

5. **Organizational Structure**
6. **Methods of Assigning Authority and Responsibility**
7. **Personnel Policies and Practices       +**

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## Segregation of Duties

**The basic goal of "segregation of duties" is that no one person should have excessive control over one or more transactions or critical processes.**

**Checks and balances are set up to limit this control.**

**The benefits are twofold:**
- **Fraud is more difficult to commit because it requires collusion.**
- **Innocent errors are more likely to be prevented or detected.**

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## Segregation of Duties

**Cash Disbursements, ideally, will segregate (1) entry, (2) approval, (3) access to cash and checks, (4) bank reconciliation, and (5) budget approval.**

**Cash Receipts, ideally, will capture the cash and check receipts with (1) a log prepared by two people or (2) a receipt as soon as a State employee first sees the receipts.**

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## Segregation of Duties in Smaller Organizations

**Maintaining segregation of duties is challenging for agencies with very small numbers of employees.**

**These situations are actually rare in State agencies since they usually have several employees. State agencies often think they are too small, to have sound internal controls.**

**In these situations, senior management may have more opportunities to override the controls or misstate the financial statements.**

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## Alternate Procedures for Smaller Organizations

**Increase supervision of the employee:**

- **Be more involved in day-to-day operations /activities and/or monitor and analyze data from reports.**

- **Periodically reperform some employee duties (such as bank reconciliations, especially reconciling items).**

- **Involve other employees with unrelated job responsibilities in limited ways.**

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## Policies and Procedures

When are departmental policies and procedures needed?

## Internal Control Group: An Agency Resource

- **Please contact the Internal Control group for recommendations.**

- **Please contact the Internal Control group before:**

    **(1) Making significant changes to your current procedures.**

    **(2) Hiring a new employee solely to implement an internal control.**

## Annual Post Audit Findings

- **25 duplicate payments.**
- **8 incorrectly paid per diems.**
- **5 incorrect object codes affecting 1099 reporting.**
- **5 payments lacking phone bids or written quotes.**

- **Numerous payments with errors that should have been found by the person approving the payments due to:**
    - **No supporting documentation**
    - **Incorrectly entered Invoice amounts.**
    - **Not agreeing payments with supporting documentation.**
    - **Not being aware of what invoices have been or still need to be paid.** **+**

## Original Receipts and Invoices

**Supporting documentation for all disbursements to vendors and employees should be made only on the basis of original receipts and invoices.**

**If the vendor does not provide a paper invoice, a printout of an electronic or faxed invoice, when received directly from the vendor, will be considered an "original receipt."**

## Original Receipts and Invoices

**Employee travel reimbursements should only be made based on original hotel bills, parking and taxi receipts, personal phone bills, and receipts for incidental items of $20 or more.**

**Agencies that scan and save supporting documentation for disbursements in an electronic format and then discard the original supporting documentation must have an agency policy to only scan "original receipts and invoices."**

## Order Splitting (Effective 5-1-13)

**Purchases up to $1,000 require management approval.**

**Purchases of a single procurement item between $1,001 and $5,000 require competitive bidding (to obtain at least two quotes) to determine the lowest quote.**

**Purchases over $5,000 require State Purchasing approval unless covered by a limited purchasing delegation (LPD) from State Purchasing or by the Utah Code.**

**Total purchases by a department, division, or unit to the same vendor in the same fiscal year exceeding $50,000 require the vendor be on a State contract (or that the department have a written exception for that vendor from State Purchasing).**

**Agencies should NOT split orders in order to stay under these limits.**

## Prevent or Detect Fraud other than through Collusion

**Internal controls are designed to prevent and/or detect errors and fraud – except in the case of fraud by collusion. Generally, internal controls strong enough to prevent and/or detect fraud by collusion are not cost effective.** **+**

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## Diverting cash receipts

**Diverting cash and check receipts from the regular process should not be permitted.**

**This practice is especially dangerous when the receipts are "unexpected."**

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## Cash Receipts

**Why is it so important for State agencies to either:**

(1) **require those who handle cash receipts to take vacations, or**

(2) **rotate the duties periodically of those who handle cash receipts?**

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## Reconciliation/Communication

**Why are reconciliations important?**

**Why is communication so important?**       +

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## New Bank Accounts & Foundations

**Before opening a new bank account, please:**
1) **Call the State Treasurer's Office.**
2) **Review relevant State policies on the Division of Finance website [FIACCT 19-01.00].**

**Before establishing a new tax-exempt foundation, please:**
1) **Ensure you have the needed legislative authority.**
2) **Reconsider the need for such a foundation since the State of Utah is already tax exempt.**

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## Cost Versus Benefit of Internal Control

**The cost of a control should not exceed the benefit to be derived from it.**

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## Internal Controls Not Foolproof

**Dear Public, Press, & Financial Statement Users:**

**Internal control can provide reasonable, not absolute, assurance that the objectives of an agency will be met.**

**Reasonable assurance implies a high degree of assurance, constrained by the costs and benefits of establishing incremental control procedures.**

## Cost Benefit of Prevention Versus Detection

**A control that prevents a loss is usually superior to a control that detects a loss after it has occurred.**

**Manual preventative controls are more expensive.**

**Early detection is essential if prevention fails.**

**When a failure occurs, corrective action reduces future losses.**

## Cost Benefit of Compliance

**Compliance with laws, regulations, and policies and procedures is required.**

**Waivers are the exception, not the rule.**

**Those organizations issuing the laws, regulations, and policies and procedures have or should have already determined that compliance is cost beneficial.**

## Whistleblowing

**What do you do when you go to your supervisor with evidence or suspicion of mismanagement or fraud, and no action is taken?** **+**

## Expanding Influence of the Program

**State Finance has no authority over the following:**

- **Courts.**

- **Legislature.**

- **Higher Education.**

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**Website:**
**http://finance.utah.gov/controls.html**

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